85-196 (3)

No. ———

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

IN RE: RALPH MILLER,
Debtor,

RALPH MILLER,
Petitioner,
v.

FIRST FEDERAL OF MICHIGAN,
Respondent.

IN RE: EDWARD J. PIGLOSKI and
MARY L. PIGLOSKI,
Debtors,

EDWARD J. PIGLOSKI and
MARY L. PIGLOSKI,
Petitioners,
v.

MAXINE WYNN and MANOR MORTGAGE CO.,
Respondents.

On Petition for Writ of Certiorari to the Sixth Circuit Court of Appeals

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RESPONDENT'S BRIEF IN OPPOSITION

W. STANLEY FAMBROUGH
FIRST FEDERAL OF MICHIGAN
1001 Woodward Avenue
Detroit, Michigan 48226
(313) 965-1400
Attorney for Respondent
First Federal of Michigan

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COUNTERSTATEMENT OF QUESTION PRESENTED

Does 11 U.S.C. Section 1322(b)(5) give a debtor authority to set aside a forecloseure sale of his residence, to reinstate the original mortgage loan terms and to cure the loan default through a Chapter 13 plan where the bankruptcy petition was filed after the foreclosure sale?

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RESPONDENT'S BRIEF IN OPPOSITION

ARGUMENT

I. There is no conflict between the decisions of the Second and Sixth Circuits.

Petitioners seek to base their petition on an alleged conflict between the Second and Sixth circuits. There is no conflict. It was argued to the Second Circuit in *Taddeo*, 685 F.2d 24 (2d Cir. 1982) that, once a default in the long-term installment loan occurred and the lender had accelerated the remaining principal balance, the loan had been converted into an obligation similar to a demand instrument and was no longer subject to the provisions of Section 1322(b)(5) of the Bankruptcy Code.[1] This section, if taken literally, only applied to those loans ". . . on which the last payment is due after the date on which the final payment under the plan is due." Since the loan payments could not possibly, after acceleration, extend beyond the plan, the debtor[2] could not rely on this section as authority to cure the default and reinstate the loan terms.

The *Taddeo* Court rejected this argument primarily for two reasons. It was concerned about the lack of notice to the borrowers of the acceleration and, consequently, the borrower's inability to consult with an attorney before Section 1322(b)(5) was lost as an option to the borrower. Secondly, it believed that if Section 1322(b)(5) could be so easily side-stepped it would become unavailable to all but a select few. The Court held that acceleration of the debt, by itself, was not sufficient to render Section 1322(b)(5) unavailable to the borrower.

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[1] The Bankruptcy Act of 1898 will be referred to as the "Act" and the Bankruptcy Reform Act of 1978 will be referred to as the "Code".

[2] For the most part, a debtor in Chapter 13 has the same powers as a trustee in Chapter 7 or 11. Therefore references herein to "debtor" or "trustee" should be read as interchangeable as the context warrants.

The *Taddeo* court used, without qualifying it, overly broad language to explain its holding. (Pet. p. 13). What the court failed to state (perhaps because the issue wasn't before it) is that there must come a point in time where the debtor has waited too long to undo the contractual consequences of the default. It would seem obvious that the Court did not mean to suggest that the right to cure a default should exist as an absolute right, impervious to the running of time and to changes in legal relationships. The *Glenn* opinion 760 F.2d 1428 (6th Cir. 1985) recognizes that there is a point where the borrower has waited too long to assert his right to cure the default through a Chapter 13 bankruptcy case. These two cases are not in conflict. They are addressing the situation at two different points in time. In *Taddeo*, the lender had commenced foreclosure proceedings but had not obtained a final judgment of foreclosure and sale. In *Glenn* the lender had already conducted the foreclosure sale. So far, under both the Bankruptcy Act and Code, no circuit court decision has held that a debtor may set aside a foreclosure sale and reinstate his mortgage.

Another reason to draw the line at the foreclosure sale has been advanced by *In re Young*, 48 B.R. 678 (Bkrtcy. E.D. Mich. 1985) which points out that the purchaser at a foreclosure sale is not the holder of a secured claim at all. Section 101(4) of the Code defines "claim" as a right to payment or to an equitable remedy for breach of performance. The purchaser at a foreclosure sale does not enter into a contractual relationship wherein he has the right to demand either from the mortgagor. The only thing the purchaser owns is equitable title which will ripen into full legal title unless the redemption price is paid, but the purchaser can not demand any performance from the mortgagor. Therefore he does not hold a "claim" and Section 1322(b)(5) is inapplicable.

Petitioners argue (Pet. p. 13) that the *Taddeo* Court would have held the power to cure continues to exist even after the foreclosure sale. However, on the same page, petitioners concede that, in New York, a debtor does not have the right to redeem after a foreclosure sale. Petitioners fail to explain what the *Taddeo* court would have based this power to cure on since the debtor in New York would not have any interest in the collateral after the sale.

It should also be noted that the reasoning in *Taddeo* is less than persuasive. In response to the argument that Section 1322(b)(2) prohibited any modification to the rights of a holder of a secured claim in the debtor's principal residence, the *Taddeo* court held that the prohibition against modifying the rights of creditors found in subsection (b)(2) was only intended to insure that a plan preserved the size and frequency of the installment payments as they were originally contracted. This unique definition of "modify" was rejected by the Ninth Circuit in *Seidel*, 752 F.2d 1382 (1985) at pages 1384-1386. The word "modify" should not have such a narrow definition in a bankruptcy context. It should have the same meaning in the Code as it does in every day common usage. The *Seidel* court adopted the "plain meaning" rule of statutory interpretation. See also *Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 477 U.S. 102 at 108 (1980), *NLRB v. Amax Coal Co.*, 453 U.S. 322 at 329 (1981) and *Watt v. Alaska*, 451 U.S. 259 at 266 (1981). Presumably the *Seidel* court, if the issue had been before it, would have applied the same rule of statutory interpretation to the phrase "curing any default". Setting aside a foreclosure sale is no longer simply a matter of curing a default. It is a modification of the rights of the secured creditor and the purchaser at the foreclosure sale.

II. The plain meaning of Section 1322(b)(5) does not provide for setting aside a foreclosure sale and reinstating a mortgage loan upon its original terms.

This is a clear case of where the plain meaning of the statute should be given effect. Language used in a statute which has a settled and well known meaning sanctioned by judicial decision is presumed to be used in that sense by the legislative body. *Kepner v. U.S.*, 195 U.S. 100 at 124 (1904).

The specific language in Section 1322(b)(5) merely provides for curing a default and maintaining the regular installment payments while the plan is in effect. The basic assumption underlying Section 1322(b)(5) is that there is still a long term installment loan in existence under non-bankruptcy law. This section is completely silent as to what a Chapter 13 debtor may do when the collateral had already been sold, before the bankruptcy filing, at an auction sale to satisfy the debt. This congressional silence is presumptive evidence that Congress did not intend, let alone even contemplate, vesting the Bankruptcy Courts with the power to set aside a foreclosure sale which had occurred prior to the bankruptcy filing.

The cases which have found authority in Section 1322(b)(5) to set aside foreclosure sales have ignored the specific language of the statute and relied instead upon a vague notion of furthering the rehabilitation of the debtor, e.g. *In re Thompson*, 17 B.R. 748 (Bkrtcy. W.D. Mich. 1982) at page 752. They point out the Congressional intent, in general, was to make Chapter 13 proceedings more accessible to debtors under the Code than it was under the Act. At best, this ignores the balancing of competing interests that went into the legislative process. *Glenn* at pages 1433-34. At worst, this is legislation by judicial fiat.

The Circuit Court cases, *Taddeo*; *Glenn*; *In re Grubbs*, 730 F.2d 236 (5th Cir. 1984); and *In re Clark*, 738 F.2d

869 (7th Cir. 1984), have all examined the legislative history in detail and one fact has been conspicuous by its absence. Not one case has been able to find a single statement by anyone involved in the legislative process wherein the specific possibility of setting aside a mortgage foreclosure sale was even discussed. If that concept had even remotely entered the minds of those who were drafting the Code, there is no doubt that such a possibility would have generated hours of hearings and debates.

This statement can be made with assurance because the mere suggestion that the legal efficacy of a foreclosure sale could be cast into doubt by a subsequent bankruptcy filing would have sent seismic shock waves throughout the mortgage lending industry. Not only would it have affected how the loan originators underwrote their lending risks, but it would also have affected how mortgages were purchased and serviced in the secondary market. Today, after arguing this issue for several years, it has lost some of its novelty, but in 1978, when the Code was passed, the concept was unheard of. It could not have passed through both houses of Congress without provoking some comment from some quarter.

This argument is buttressed by three points. Congress had, in the past, passed a specific statute tolling the redemption period after a foreclosure sale by means of a bankruptcy filing. This is the 1935 amendment to the Frazier-Lemeke Farm Mortgage Act (August 28, 1935, Number 384, 49 Stat. 942) which was an "emergency measure" (see section 6 of the amendment) enacted in the midst of the Great Depression. Therefore, Congress clearly had historical precedent before it if Congress wanted to enact such a law. It is reasonable to assume that if Congress had clearly expressed its intent to toll the running of redemption periods in 1935, it could have just as clearly expressed that intent (if, in fact, such was its intent) in 1978. See *Johnson v. First National Bank of Montevideo*, 719 F.2d 270 (8th Cir. 1983) at page 276.

Secondly, there are two other sections in the Code where Congress specifically intended to give the trustee power to set aside conveyances or transfers which occurred prior to the bankruptcy filing. They are Section 547 (preferential transfers) and Section 548 (fraudulent conveyances). If Congress had intended to give the debtor power to set aside a foreclosure sale which occurred prior to the bankruptcy filing then it could have spelled out that power in the same manner as it did in these two sections. Since Congress did not do so, then it is reasonable to conclude that Congress did not intend to allow it.

Third, Congress did provide, where the foreclosure sale occurred prior to the bankruptcy filing, a specific mechanism to toll the redemption period and to allow the trustee to redeem the debtor's property if it had value in excess of the price brought at the foreclosure sale. In Section 108(b) of the Code, a trustee is guaranteed a minimum of 60 days in which to redeem the property. In effect, this is a specific statutory tolling of the redemption period so that the trustee has time to determine if there is any equity in the property and to explore ways to obtain credit to redeem from the purchaser at the foreclosure sale. Section 364 of the Code provides authority for the trustee to obtain credit from another lender. Bankruptcy Rule 6008 gives specific authority to the trustee to redeem property. The important point is that this was the mechanism which Congress put in place to deal with foreclosure sales occurring prior to the bankruptcy if there was excess value in the property.

III. It isn't the property itself that becomes part of the bankruptcy estate, but rather it is the debtor's interest in the property which becomes part of the estate and a Bankruptcy Court may not enlarge that interest.

Section 541 of the Code defines what comprises the bankruptcy estate. It provides that ". . . all legal or equitable interests of the debtor in property as of the commencement of the case . . ." become part of the estate.

The legislative history indicates that state law would determine the extent of the debtor's interest in the property, and that the trustee would take no greater rights in the property than were possessed by the debtor when he filed his petition. See House Report No. 95-595, 95th Cong., 1st Sess. 367-8 (1977); Senate Report No. 95-989, 95th Cong. 2nd Sess. 82-3 (1978), and *Johnson* (8th Cir.) at pages 273-4.

Bankruptcy Courts are not free to fashion substantive rights that the state itself does not provide, or ignore the rights and duties the state has established. The Bankruptcy Code provides no federal authority to create a uniform commercial law. A bankruptcy court may not enlarge the debtor's property rights beyond those created under state law. See *Butner v. United States*, 440 U.S. 48 at 55 (1979) and *Stellwagen v. Clum*, 245 U.S. 605 (1918).

The statutory right of redemption, not the real property itself, becomes part of the estate. *Collier on Bankruptcy*, 15th Ed; 4:541.07(3) and *Johnson* (8th Cir.) at 276.

Under Michigan law a debtor continues to hold legal title to the property but it is a defeasible title. It is not a fee simple absolute title. *Dunitz v. Woodford Apartments Co.*, 236 Mich. 45, 209 NW 809 (1926) pages 49-50. If the mortgagor fails to redeem within the period allowed by statute, his interest in the property is extinguished automatically. *Dunitz v. Braver*, 252 Mich. 114, 233 NW 347 (1930), *Detroit Fidelity & Surety Co. v. Donaldson*, 255 Mich. 129, 237 NW 380 (1931). The mortgagor must pay the full amount within the redemption period. *Heimerdinger v. Heimerdinger*, 299 Mich. 149, 299 NW 844 (1941). Equitable title is transferred to the purchaser upon a foreclosure sale and the right of redemption is not an interest in land, but a mere personal privilege given by statute to the mortgagor after the land

has been sold. *Gerasimos v. Continental Bank*, 237 Mich. 513, 212 N.W. 71 (1927). If a bankruptcy court may allow the debtor additional time to redeem the property then that is an impermissible expansion of the rights possessed by the debtor and a corresponding reduction of the rights possessed by the purchaser at a foreclosure sale.

Petitioners argue (Pet. p. 15) that the right to cure exists as long as a debtor continues to have an interest in the collateral at the time he files his petition. That should not be the test. The expression "cure a default" has been commonly understood to imply that there is still a loan in existence and that the collateral has not been sold to satisfy the obligation. The test should be whether the creditor has exercised the remedies available to him under state law and changed the nature of the obligation. To suggest that the statutory right to redeem (i.e. the right to repurchase the collateral at the price bid for it at the foreclosure sale) also gives the debtor the right to revive the debt obligation is to stretch the concept of "curing a default" beyond all reason.

The petitioners also invoke (Pet. pp. 15-16) the spectre of unequal treatment of borrowers from state to state. That is, in one state a borrower might be given more notice of an impending sale, or in another state he might be given more time to redeem the property after the sale. Therefore, the petitioners argue, the Bankruptcy Code will be applied in an unequal manner and there won't be a uniform bankruptcy law.

In response to this argument, the Bankruptcy Code does not spring into existence out of a void. There is no bankruptcy "common law" which defines property rights. Property rights are defined by state law. In effect, state law is the foundation and bankruptcy law is the structure resting on it. State law has, and always will, vary from state to state, but this is not a sufficient justification to dispense with this basic concept of the relationship be-

tween state law and bankruptcy law. To take the petitioners' argument to its logical conclusion, it would require a bankruptcy judge to scan the laws of each of the fifty states to find which one gives a borrower the most notice, the most time to redeem, the best terms for the sale, etc., and then incorporate the foreign law into the laws for the home state or use it to preempt any law of the home state which might be contrary to what he has selected as the most liberal for the debtor. If there is more than one issue involved, should the judge choose statutes from several different states and incorporate all of them into the laws of the home state? How does he determine which state law is the most beneficial to the debtor at any particular point in time? How are the attorneys to know which state law is applicable to their case? How can they advise their clients? If there is a conflict between various states, should the bankruptcy judge render an opinion on each state law and then choose the bits and pieces from each state he believes to be the most beneficial to the debtor? Clearly, it would be an impossible situation.

Petitioners cite *Kokkinis*, 22 B.R. 353 (Bkrtcy. M.D. Ill. 1982) as support for the argument that a debtor could accomplish the same thing under Section 1322(b)(3) or (b)(10). If a debtor could use either of those sections in place of Section 1322(b)(2) and (b)(5), then the latter sections would be rendered superfluous. See the discussion of Sections 362 and 108 below.

Petitioners argue that setting aside a foreclosure sale does not materially affect the rights of the mortgagee since the mortgagee will be restored to its original position. (Pet. pp. 13-14). The legislative history cited by petitioners relates to an issue found only in Chapter 11; i.e., whether a secured creditor's claim is impaired if a debtor is allowed to reinstate the original terms of an obligation after the secured creditor had declared it in default and accelerated the debt. "Materially affected" is

merely a test to determine whether a claim is "impaired" or not. "Impaired" is not a concept found in Chapter 13 and the whole discussion is irrelevant. Moreover, it is not just a question of whether the rights of the mortgagee will be materially affected. The rights of the purchaser at the foreclosure sale will, without question, be materially affected and he and the mortgagee are not always one and the same.

IV. Case law under the Act.

In evaluating case law under the Act, *Hallenbeck*, 323 F.2d 566 (4th Cir. 1963) was a leading decision. However it was a pre-foreclosure sale case. The only issue was whether a bankruptcy court could enjoin a creditor from commencing a foreclosure sale, despite the statutory limitations found in the Act. Section 1322(b)(5) of the Code is the statutory embodiment of *Hallenbeck*. See *United Companies Financial Corp. v. Brantley*, 6 B.R. 178 at 190 (Bkrtcy. N.D. Fla. 1980). The *Grosso Investments Inc.*, 457 F.2d 168 (9th Cir. 1972) opinion can only be explained as an aberration from the majority of the cases under the Act. See the cases collected in *Johnson* (8th Cir.) at page 277. It is the only circuit court decision under the Act which held that the Bankruptcy Court had the power to stay the running of the redemption period. The central deficiency of the *Grosso* opinion lies in its view of the relationship between state law and bankruptcy law. In short, the court was not overly concerned with what interests in property the debtor possessed under state law. See page 172. The Court determined that the debtor still possessed "legal title" to the property after the sale and that determination settled the issue for the Court without further inquiry into the nature and extent of the "legal title". For example, the so-called "legal title" after a foreclosure sale in Michigan is a defeasible title upon the expiration of the statutory redemption period, *Supra*. It appears that the *Grosso* court starts with the proposition that the bankruptcy

laws exist for the sole benefit of the debtors and as long as state laws support a conclusion beneficial to the debtor, they may be relied upon; however, to the extent that they do not square with that proposition, then they are preempted by the federal bankruptcy laws, or simply ignored. This selective use of state law renders the *Grosso* decision questionable as precedent. The *Freed*, 534 F.2d 1235 (6th Cir. 1976) and *Chatman*, 527 F.2d 691 (6th Cir. 1975) opinions are both *Hallenbeck* types cases.

V. The relationship between Section 362 and Section 108.

Section 362 does not operate to toll the running of the redemption period. The *Bevan*, 13 B.R. 989 (E.D. Mich. 1981) and *Johnson*, 8 B.R. 371 (Bkrtcy. D. Minn. 1981) decisions were published almost simultaneously. The overwhelming majority of the cases have chosen to follow the analysis made by *Bevan* as to the relationship between Section 362 and Section 108. See *Johnson* (8th Cir.) at 275-8. *Bevan* held that the specific section of a statute controls the general section. *D. Ginsberg & Sons, Inc. v. Popkin*, 285 U.S. 204 at 208 (1932); *Kepner v. U.S.*, 195 U.S. 100 at 125 (1904). A statute should be interpreted so as not to render one part inoperative. *Colautti v. Franklin*, 439 U.S. 379 at 392 (1979); *Reiter v. Sonotone Corp.*, 442 U.S. 528 at 538-9 (1955); *Market Co. v. Hoffman*, 101 U.S. 112 at 115-6 (1879).

The analysis (Pet. p. 28) made in *H & W Enterprises, Inc.*, 19 B.R. 582 (Bankrtcy. N.D. Iowa 1982) is wrong because it ignores the legislative history. The phrase, "including any suspension of such period occurring on or after the commencement of the case" refers to any non-bankruptcy law that tolls the running of applicable time limits. Section 108(c) contains the same phrase. The legislative comments to subsection (c) of Section 108 make it clear that the drafters were referring to any non-bankruptcy law, such as the Internal Revenue Code which provides that the statute of limitations on collec-

tion of non-dischargeable tax liability will resume running six months after the expiration of the Bankruptcy Court's control over the debtor's assets. In short, a creditor gets the benefit of any suspension of the statute of limitations provided by non-bankruptcy law and is guaranteed a minimum of thirty days after the expiration of the stay to pursue his remedies. See 124 Cong. Rec. H 11, 109 (Sept. 28, 1978); S 17426 (Oct. 6, 1978). Conversely, the trustee, under Section 108(b), gets the benefit of any suspension of a time limitation granted by non-bankruptcy law; but is guaranteed a minimum of sixty days from the date of the petition to decide what he is going to do with the assets of the estate.

CONCLUSION

For the reasons set forth above, the petition for certiorari should be denied.

Respectfully submitted,

W. STANLEY FAMBROUGH
FIRST FEDERAL OF MICHIGAN
Suite 4-W
1001 Woodward Avenue
Detroit, Michigan 48226
(313) 965-1400
Attorney for Respondent
First Federal of Michigan